



State of Rhode Island and Providence Plantations

Revenue & Caseload Estimating Conference

ROOM 306, STATE HOUSE, PROVIDENCE, RI 02903

May 12, 2003

To: The Honorable Donald L. Carcieri, Governor
The Honorable William J. Murphy, Speaker of the House
The Honorable William V. Irons, President of the Senate

From: Michael O'Keefe, House Fiscal Advisor *Michael O'Keefe*
Rosemary Booth Gallogly, State Budget Officer *Rosemary Gallogly*
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Subject: May 2003 Consensus Revenue Estimating Conference

Summary

The Revenue Estimating Conference concluded its deliberations May 12 in open public meetings to adopt the economic forecast and review and revise the estimated revenues for FY 2003 and FY 2004 adopted at the November 2002 conference as modified in January 2003. The Conference revised the FY 2003 estimate downward by \$13.9 million based on collections trends through April and the revised economic forecast, and revised the FY 2004 forecast downward by \$22.6 million based on its FY 2003 revisions and the new economic forecast.

The estimates are based on current laws and the new agreement between the Lottery Commission and GTECH. Tables showing the estimates and the changes are included at the end of this report.

Economic Forecast

On April 30th, the Conferees heard forecasts for the national and Rhode Island economies from Steven Cochrane, Director of Regional Economics for Economy.com and David Pace, economist of Global Insight. They also received testimony from Robert J. Langlais, Assistant Director, Labor Market Information, Department of Labor and Training, concerning the latest labor market data for the state. The Conferees adopted a revised economic forecast for Rhode Island.

National Economic Outlook. As last year ended, the US economy faltered in its struggle to recover from the recession that began in March 2001. During the past two quarters the pace of

real growth slowed below 2.0 percent, which is considerably less the 3.0 to 3.5 percent range expected at the November Conference. Economy.com and Global Insight generally agree that war worries caused consumer and business confidence to plunge and oil prices to rise, taxing the economy with increased risks and higher energy bills. As the Iraq war heated up last fall and commenced this spring, these dour effects on attitudes were the main forces that held back business investment spending and curtailed consumer spending during the critical holiday season.

Looking forward, the consultants' most likely scenario has the national economy picking up later this year; but with an expected pace of recovery significantly less than presented to the November 2002 Conference. Real gross domestic product (GDP) growth is now expected to average 2.6 percent this year, as the economy fails to gain speed until the second half of 2003. This is slower than the 3.0 percent forecast in November. In 2004, both forecasters expect the recovery to pick up speed, allowing real GDP to expand in the 3.5 to 4.0 percent range.

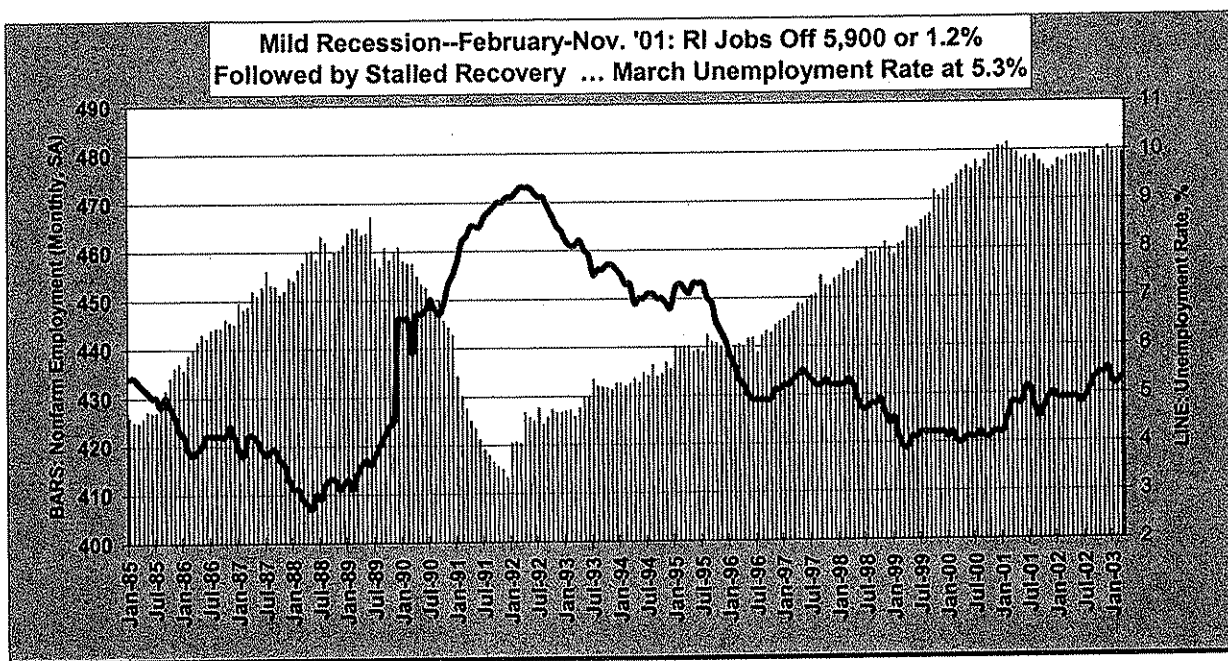
Now that the US has prevailed militarily in Iraq, allowing operations to begin winding down, both forecasters foresee a consequent recovery in consumer confidence and improved business attitudes to foster faster growth. The economic speed-up will be headed by more business investment spending, especially in high tech, while consumers enjoy an "energy tax cut" caused by crude oil prices falling to about \$26 a barrel, down some \$10 from its high during the war.

In this environment, the Federal Reserve Board is expected to hold the federal funds rate at the current 1.25 percent level before commencing to tighten monetary policy later this year or in early-2004. That tightening will accompany higher interest rates for bonds and mortgages as well, curtailing the benefits of lower mortgage rates, thereby threatening the ongoing home construction and price boom. Overall inflation should stay moderate, allowing the cost of living, as measured by the US consumer price index, to slow from this fiscal year's 2.4 percent pace to 1.8 percent next year before leveling off at a moderate 2.2 to 2.3 percent rate thereafter.

The economic consultants agree that the legacy of the war and the currently sluggish economy means that there are greater risks that this outlook could again prove to be too optimistic. For example, David Pace of Global Insight says that the baseline forecast has only a 60 percent chance to be right. He judges that the risk of things going wrong, causing a more pessimistic economy, has an uncomfortably high chance of 25 percent. Accordingly, this leaves only a 15 percent chance that the economy could perform better than the baseline outlook.

Rhode Island Outlook. Rhode Island is doing relatively better than its bigger neighbors nearby, continuing to be somewhat insulated from the severity of the national and regional recession that has had more harmful effects on such technology-laden states as Massachusetts. For example, jobs have been declining for about two years in Massachusetts with losses of over 100,000 jobs or 3.25 percent and continuing to decline. Rhode Island has suffered a 5,900-job loss, or a 1.2 percent decline, over the February-November 2001 period.

However, since the low point in November 2001, Rhode Island's job recovery has been quite erratic and actually faltered last October when a slight downtrend began. Accordingly, through March of this year, payroll employment stands at 472,600 jobs, up only 0.5 percent over the past twelve months. So, latest employment levels are still below the peak of 481,600 set back in February 2001 before the recession began. This has pushed the state's unemployment rate consistently above 5 percent, to sit at 5.3 percent in March.



Rhode Island's relative insulation from the full force of the investment and technology bust has not kept its economy entirely safe from faltering, though not as badly as many other states. The roaring housing market, with median home resale prices scaling above \$200,000, has maintained the economy. Both the housing and commercial real estate markets have been bolstered by interstate spillovers, particularly of residents moving here.

With mortgage rates about to rise, office vacancy rates in the Boston metro market already risen, and the sheer prolonging of the recession in Massachusetts, even Rhode Island will be facing more forward-going weakness as these ripple effects turn negative. This exacerbates the continued loss of manufacturing jobs, not to mention the loss of business service jobs that has commenced here recently.

Taking account of these crosscurrents, and the lowered expectations about the national outlook, the Conferees adopted an even weaker recovery forecast for the state. The estimators now expect employment to rise 0.2 percent this fiscal year, hardly growing at all, compared with the 0.4 percent gain expected at last November's conference. This reduces the growth outlook for wage and salary income to just 3.7 percent for FY 2004, off significantly from last November's consensus estimate of nearly 4.0 percent. Wage and salary incomes are important drivers of state

personal income tax withholding revenues. Also, slower growth here and in nearby Massachusetts will likely take a toll on shopping demand, and therefore sales taxes.

The lagging effects of a much slower recovery also take a toll on the outlook for FY 2004, when employment growth of merely 0.7 percent translates into just a 3.5 percent rise in personal income, which is considerably lower than the 4.3 percent, November 2002 consensus forecast. Softer wage gains also translate into just a 4.3 percent rise in wage and salary income in FY 2004, again significantly slower growth than the 4.7 percent forecast adopted last November.

May 2003 Consensus Economic Forecast												
Annual Growth	CY 2000	CY 2001	CY 2002	CY 2003	CY 2004	CY 2005	CY 2006	CY 2007	CY 2008	CY 2009	CY 2010	CY 2011
Nonfarm Employment	2.4	0.4	0.1	0.3	1.0	1.3	0.8	0.7	0.7	0.7	0.7	0.7
Personal Income	6.9	4.3	4.5	3.2	3.8	4.2	4.2	4.2	4.4	4.7	4.8	4.9
Wage and Salaries Income	7.0	3.2	4.1	3.3	5.2	5.2	4.6	4.6	4.6	4.6	4.7	4.7
Farm Income	-59.1	-55.6	25.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfarm Business Income	5.3	3.0	6.0	3.5	8.0	5.0	5.1	4.7	4.5	4.4	4.4	4.4
Dividends, Interest and Rent	8.6	2.5	0.9	0.0	0.0	2.0	2.5	3.0	4.0	5.0	5.0	5.0
Total Transfer Payments	3.6	11.1	10.6	5.5	2.4	2.9	3.4	4.0	4.2	4.2	4.2	4.2
Rates												
Unemployment Rate	4.1	4.8	5.1	5.4	5.1	4.8	4.8	4.8	4.7	4.7	4.7	4.7
Consumer Price Index (US)	3.4	2.8	1.6	2.4	1.8	2.3	2.2	2.2	2.3	2.3	2.3	2.3
Ten Year Treasuries	6.0	5.0	4.6	4.1	5.0	5.3	6.0	6.0	6.0	6.0	6.0	6.0
Three Month Treasuries	5.8	3.4	1.6	1.2	2.4	3.3	4.0	4.0	4.5	4.6	4.7	4.8
Annual Growth	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Nonfarm Employment	2.3	1.6	-0.3	0.2	0.7	1.2	1.1	0.8	0.7	0.7	0.7	0.7
Personal Income	5.2	6.1	3.8	4.1	3.5	4.0	4.2	4.2	4.3	4.6	4.8	4.8
Wage and Salaries Income	6.1	5.5	2.9	3.7	4.3	5.2	4.9	4.6	4.6	4.6	4.7	4.7
Farm Income	-28.6	-66.7	-15.3	12.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfarm Business Income	6.6	3.3	4.5	4.8	5.8	6.5	5.1	4.9	4.6	4.5	4.4	4.4
Dividends, Interest and Rent	3.0	7.2	0.5	0.5	0.0	1.0	2.3	2.8	3.5	4.5	5.0	5.0
Total Transfer Payments	3.6	6.9	12.1	8.1	4.0	2.7	3.2	3.7	4.1	4.2	4.2	4.2
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Ten Year Treasuries	6.2	5.4	5.0	4.4	4.6	5.2	5.7	6.0	6.0	6.0	6.0	6.0
Three Month Treasuries	5.2	5.1	2.2	1.4	1.8	2.9	3.7	4.0	4.3	4.6	4.7	4.7

Revenues

Taxes. Revenues from taxes are estimated to increase 5.2 percent over the prior year in FY 2003. Total estimated taxes for FY 2003 of \$2,003.7 million are \$8.1 million below the November conference estimates. FY 2004 total estimated taxes are \$2,099.9 million, \$11.2 million below the November conference estimate, and \$96.2 million, or 4.8 percent, above revised FY 2003 estimated tax revenues.

Personal Income Tax. The estimates of \$808.9 million for FY 2003 and \$853.0 million for FY 2004 represent growth rates of 0.1 percent and 5.5 percent respectively, and are \$20.8 million below the previous estimate for FY 2003 and \$22.1 million for FY 2004. The reductions are largely due to refunds significantly higher than estimated for FY 2003 with subsequent revision to FY 2004 based on the revised FY 2003 estimates. The November conference had estimated refunds for FY 2003 at \$150.0 million, which included \$7.1 million that the estimators had earlier thought would have been paid in FY 2002. Information provided by the Division of

Taxation showed that refunds and adjustments processed through early May were well ahead of last year, causing the estimators to revise the FY 2003 estimate to \$177.4 million, a difference of \$27.4 million.

The revised estimate for FY 2004 of \$170.3 million reflects an assumption of level refunds minus the \$7.1 million adjustment made in FY 2003. FY 2002 refunds were \$147.1 million.

May 2003 Consensus Revenue Estimates	FY 2002		FY 2003 Estimate		FY 2004 Estimate	
Personal Income Tax	\$ 808,156,977	-11.6%	\$ 808,900,000	0.1%	\$ 853,000,000	5.5%
General Business Taxes						
Business Corporations	32,737,268	-52.4%	64,000,000	95.5%	66,800,000	4.4%
Public Utilities Gross	80,813,973	-1.6%	74,000,000	-8.4%	77,800,000	5.1%
Financial Institutions	3,385,254	-82.3%	1,400,000	-58.6%	1,500,000	7.1%
Insurance Companies	32,351,133	-13.6%	49,500,000	53.0%	50,600,000	2.2%
Bank Deposits	1,138,120	18.6%	1,400,000	23.0%	1,430,000	2.1%
Health Care Provider	27,843,707	1.9%	28,600,000	2.7%	29,600,000	3.5%
Sales and Use Taxes						
Sales and Use	745,688,792	4.6%	778,200,000	4.4%	810,600,000	4.2%
Motor Vehicle	45,842,821	3.2%	46,800,000	2.1%	48,200,000	3.0%
Motor Fuel	812,578	-29.4%	600,000	-26.2%	620,000	3.3%
Cigarettes	85,478,818	42.3%	96,500,000	12.9%	104,800,000	8.6%
Alcohol	10,039,097	9.1%	10,000,000	-0.4%	10,300,000	3.0%
Controlled Substances	-	-	-	-	-	-
Other Taxes						
Inheritance and Gift	22,244,910	-17.3%	30,000,000	34.9%	30,700,000	2.3%
Racing and Athletics	5,470,031	0.0%	5,000,000	-8.6%	5,000,000	0.0%
Realty Transfer	2,665,416	4.3%	8,800,000	230.2%	8,900,000	1.1%
SubTotal - Taxes	1,904,668,895	-5.3%	2,003,700,000	5.2%	2,099,850,000	4.8%
Department Receipts	244,340,288	-6.6%	284,000,000	16.2%	216,000,000	
Gas Tax Transfer	546,830	-93.6%	10,507,500	1821.5%	9,440,000	-10.2%
Other Miscellaneous	232,339,320	139.5%	155,600,000	-33.0%	35,120,000	-77.4%
Lottery	214,141,576	18.5%	238,500,000	11.4%	280,300,000	17.5%
Unclaimed Property	7,419,763	66.3%	8,800,000	18.6%	9,060,000	3.0%
Total General Revenues	\$ 2,603,456,671	1.5%	\$ 2,701,107,500	3.8%	\$ 2,649,770,000	-1.9%

Business Taxes. The Conference estimates \$218.9 million in FY 2003 and \$227.7 million in FY 2004. Growth rates are 22.8 percent and 4.0 percent, respectively. The FY 2003 estimate is \$17.4 million more than the November conference estimate; FY 2004 is \$17.5 million more. Losses in public utilities gross earnings tax estimated revenues and financial institutions estimated revenues were more than offset by large gains in estimates for business corporations in both years.

Consumption Taxes. The Conferees adopted \$932.1 million for FY 2003 and \$974.5 million for FY 2004 from the consumption taxes, growth of 5.0 and 4.6 percent respectively. These estimates are less than the November estimates by \$5.8 million and \$7.7 million. The lowered estimates are mainly from cigarette taxes, which are \$5.3 million and \$5.4 million less than the November conference estimates.

The estimators maintained the sales tax estimate of \$778.2 million in FY 2003 and lowered the FY 2004 estimate slightly by \$1.4 million to \$810.6 million. Estimated sales tax growth is 4.4 percent in FY 2003 and 4.2 percent in FY 2004. The estimators are concerned that the housing market may soften, weakening those estimates.

Other Taxes. The inheritance, racing and athletics, and realty transfer taxes are estimated to produce \$43.8 million in FY 2003 and \$44.6 million in FY 2004. The FY 2003 estimate is \$1.1 million above the November estimate; FY 2004 is \$1.0 million more.

Other Sources. Other source revenue consists of departmental revenues, transfers to the general revenue fund from gas tax deposited in the transportation fund, the lottery, unclaimed property, and other miscellaneous sources, including tobacco settlement funds. These are estimated to produce \$697.4 million in FY 2003 and \$549.9 million in FY 2004. The FY 2003 estimate is \$5.8 million less than previously estimated; the FY 2004 estimate is \$11.4 million less.

Departmental Receipts. The estimators adopted estimates of \$284.0 million in FY 2003 and \$216.0 million in FY 2004 for these sources that include licenses and fees, fines and penalties, sales and services, and miscellaneous departmental earnings deposited as general revenues. The FY 2003 estimate is an increase of \$7.4 million over the November estimate, which is the combination of \$5.1 million in downward revisions offset by \$12.5 million for the one-time payment by GTECH for certain exclusive rights granted by the Lottery Commission.

FY 2004 drops off mainly due to the end of the hospital license fee in FY 2003, which produces \$62.3 million in FY 2003. That fee has been on a year-to-year basis, and has been extended each year since its inception. However, the estimators must estimate within current law, under which there would not be a fee in FY 2004. The May estimate is \$1.0 million more than the November estimate.

Gas Tax Transfer. The estimators revised the estimated transfers downward slightly to reflect slightly lower yield per one cent of gas tax. They estimated \$4.67 million per penny, down from \$4.70 for FY 2003 and \$4.720 million in FY 2004, down from \$4.725 million. The transfers, under current law, are based on 2.25 cents in FY 2003 and 2.00 cents in FY 2004.

Lottery is estimated to transfer \$238.5 million in FY 2003 and \$280.3 million in FY 2004. The FY 2003 estimate is a downward revision of \$7.1 million over the January estimated and \$13.9 million in FY 2004. The revisions are due to lower estimated growth rates and changes due to the new agreement with GTECH.

- Games. The Conference adopted \$68.5 million for FY 2003 based on \$242.6 million of sales representing 5.1 percent growth in sales and GTECH receiving 3.4 percent of sales. The January estimate was based on 6.8 percent growth, with GTECH receiving 3.4 percent of sales.

The Conference estimates \$68.8 million for FY 2004 based on \$258.0 million in sales representing 6.4 percent growth and GTECH receiving 5.0 percent of sales under the new

agreement. That agreement with GTECH provides that it will receive 5.0 percent commission on sales to \$275.0 million, 1.0 percent on sales over \$275.0 million up to \$400.0 million, and 5.0 percent above \$400.0 million. The conferees estimate the impact of the new rate for GTECH to be \$4.0 million.

- Video Lottery Terminals. The Conference adopted \$170.0 million for FY 2003, which indicates 12.4 percent net terminal income growth to \$316.0 million. This is a downward revision of \$6.0 million from the January estimate, which was based on 16.5 percent net terminal income growth to \$327.4 million.

The Conference adopted \$211.5 million for FY 2004, based on 21.8 percent net terminal income growth to \$384.8 million and GTECH at 2.5 percent as central communication system provider and 7.0 percent on its machines. This is a downward revision to the prior estimate by \$8.5 million, which had assumed net terminal income of \$403.4 million based on 23.2 percent growth.

The estimate assumes a blended rate for the technology providers of 8.1 percent. That is based on the GTECH agreement and assumes that the GTECH machines yield will not increase beyond \$325 in net terminal income per day. GTECH would have 26.1 percent of the machines at a 7.0 percent of net terminal income rate while the other providers would remain at 8.5 percent under current law.

The new structure for GTECH is a 20-year contract with the Lottery that provides:

- As central communications provider, it will continue to receive 2.5 percent of net terminal income up to \$500 million of net terminal income, 1.0 percent on net terminal income over \$500 million to \$1,000 million, and 2.5 percent on net terminal income over \$1,000 million. There is no FY 2004 impact based on net terminal income of \$384.7 million.

- As a technology provider, GTECH is entitled to 1,860 machines, an increase of 1,000. These would come as machines are added in FY 2004 and beyond. The estimate assumes GTECH retains 860 of 3,292 machines in FY 2004, or 26.1 percent. The estimate does not include any new machines in FY 2004 at either facility. Lottery has indicated that it does not appear that Newport will be adding the expected 300 machines in May 2004.

- As a technology provider, GTECH will receive 7.0 percent on net terminal income for average weekly yields per machine up to \$325, 1.0 percent for yields over \$325 to \$500, and 7.0 percent for yields over \$500. This is a gain for the state on the GTECH machines calculated as 26.1 percent of 7.0 percent, or \$1.5 million; current law provides for 8.5 percent on the other providers.

Unclaimed Property. The Conference adopted \$8.8 million for FY 2003 and \$9.06 million for FY 2004, increases of \$1.04 million and \$1.84 million, respectively, compared to the November 2002 estimates.

May 2003 Consensus Revenue Estimates	FY 2003	Change	FY 2004	Change
Personal Income Tax	\$ 808,900,000	\$ (20,800,000)	\$ 853,000,000	\$ (22,100,000)
General Business Taxes	-	-	-	-
Business Corporations	64,000,000	19,300,000	66,800,000	20,400,000
Public Utilities Gross	74,000,000	(9,600,000)	77,800,000	(10,600,000)
Financial Institutions	1,400,000	(2,100,000)	1,500,000	(2,200,000)
Insurance Companies	49,500,000	10,300,000	50,600,000	10,500,000
Bank Deposits	1,400,000	200,000	1,430,000	200,000
Health Care Provider	28,600,000	(700,000)	29,600,000	(800,000)
Sales and Use Taxes	-	-	-	-
Sales and Use	778,200,000	-	810,600,000	(1,400,000)
Motor Vehicle	46,800,000	300,000	48,200,000	300,000
Motor Fuel	600,000	(400,000)	620,000	(580,000)
Cigarettes	96,500,000	(5,300,000)	104,800,000	(5,400,000)
Alcohol	10,000,000	(400,000)	10,300,000	(600,000)
Controlled Substances	-	-	-	-
Other Taxes	-	-	-	-
Inheritance and Gift	30,000,000	-	30,700,000	(100,000)
Racing and Athletics	5,000,000	(290,000)	5,000,000	(160,000)
Realty Transfer	8,800,000	1,400,000	8,900,000	1,300,000
SubTotal - Taxes	2,003,700,000	(8,090,000)	2,099,850,000	(11,240,000)
Department Receipts	284,000,000	7,400,000	216,000,000	1,000,000
Gas Tax Transfer	10,507,500	(67,500)	9,440,000	(10,000)
Other Miscellaneous	155,600,000	(7,093,000)	35,120,000	(325,000)
Lottery	238,500,000	(7,100,000)	280,300,000	(13,900,000)
Unclaimed Property	8,800,000	1,040,000	9,060,000	1,840,000
Total General Revenues	\$ 2,701,107,500	\$ (13,910,500)	\$ 2,649,770,000	\$ (22,635,000)